STATE OF MICHIGAN

IN THE SUPREME COURT

ON APPLICATION FOR LEAVE TO APPEAL FROM THE COURT OF APPEALS

MENARD, INC.,

Petitioner/Appellee,

v.

CITY OF ESCANABA,

Respondent/Appellant.

Supreme Court No. 154062

Court of Appeals No. 325718
MTT Docket No. 316763 &
14-001918 (Consolidated)

DYKEMA GOSSETT PLLC
By: **Carl Rashid, Jr.** (P23915)
Attorneys for Petitioner/Appellant
400 Renaissance Center
Detroit, MI 48243
(313) 568-5422

FOSTER SWIFT COLLINS & SMITH, PC
By: **Jack L. Van Coevering** (P40874)
Laura J. Genovich (P72278)
Attorneys for Respondent/Appellee
1700 East Beltline, N.E., Suite 200
Grand Rapids, MI 49525-7044
(616) 726-2221

JOHNSON ROSATI SCHULTZ & JOPPICH, PC
By: **Stephanie Simon Morita** (P53864)
Attorneys for *Amici* Michigan Municipal League *et al.*
27555 Executive Drive, Suite 250
Farmington Hills, MI 48331
(248) 489-4100

AMICUS CURIAE BRIEF IN RESPONSE TO THE APPLICATION FOR LEAVE TO APPEAL

ON BEHALF OF THE

MICHIGAN MUNICIPAL LEAGUE,
MICHIGAN TOWNSHIPS ASSOCIATION,
PUBLIC CORPORATION LAW SECTION OF THE STATE BAR OF MICHIGAN, AND
MICHIGAN ASSOCIATION OF COUNTIES

Dated: September 8, 2016

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and

COUNTER-STATEMENT AND DISAGREEMENT WITH

BASIS FOR APPEAL AND RELIEF SOUGHT

The *Amici* agree that the Appellant is appealing the May 26, 2016 Opinion of the Court of Appeals in Docket no. 325718, which is attached to its brief as Exhibit A.

The *Amici* disagree that the grounds for the Application relied upon are appropriate. In that regard, and contrary to that as stated by Appellant, the published decision of the Court of Appeals which orders a remand to correct substantial deficiencies in a non-precedential opinion rendered by a non-attorney administrative law judge in a quasi-judicial tax proceeding does not involve legal principles of major significance to the State's jurisprudence as required by MCR 7.302(B)(3). Further, the Court of Appeals Opinion is not clearly erroneous, cannot be said that it causes material injustice where it orders a remand to more fully develop the record, and does not conflict with other opinions of the appellate courts of this State as required by MCR 7.302(B)(5).

The apparent purpose of the Court of Appeals' published Opinion is to send a clear message and guidance to the Michigan Tax Tribunal as to what evidence should be considered, and to what extent, on remand in order to develop a record which is in compliance with the State of Michigan Constitution, applicable statutes, and case law, and which also supports the Michigan Tax Tribunal's decision. The application for leave should not be granted, where the Appellant has not raised as an error the order of remand to more fully develop the record itself, and Appellant is merely complaining about perceived misconceptions as to the clear directives of the Court of Appeals.

COUNTER-STATEMENT OF QUESTIONS PRESENTED

The *Amici* provide this counter-statement of the questions presented by Appellant and raise no new issues:

I. Should the Court deny Appellant's Application for Leave to Appeal, and/or affirm the decision of the Court of Appeals decision requiring a remand to the Michigan Tax Tribunal to more fully develop the record, where:

   a. the Appellant has not raised an issue involving legal principles of major legal significance to the state's jurisprudence where the issues are premised on a fiction, and which, therefore, are also technically not an appeal of the decision of the Court of Appeals where the Appellant wrongfully claims the Court of Appeals has required a value-in-use valuation by the tribunal and mandated a cost-less-depreciation valuation where the language of the Opinion states otherwise, and where the case law relied upon by the Court of Appeals, contrary to the averments of Appellant, is valid and should be followed; and,

   b. the decision of the Court of Appeals does not cause material injustice and is in concert with prior decisions of the Courts, where the Court of Appeals ordered a remand of the case to the tribunal so that the tribunal, and not the Court of Appeals, can take sufficient evidence under the law to support its decision, which allows all parties to make additional arguments, and where the weighing of that evidence is still left to the tribunal?

Appellant answers "no."
Appellee and *Amici* answer "yes."
The Tax Tribunal's answer is unknown because these issues were not raised before it.
The Court of Appeals would answer "yes".
This Court should answer "yes".

INTRODUCTION

The Court of Appeals correctly determined that the tribunal's decision contradicts the competent, material and substantial evidence on the whole record and is based on wrong principles, and therefore constituted an error of law requiring reversal. The decision of the tribunal is precedential to itself per MCL 205.751(1)[1], and if it had been allowed to stand would impact subsequent decisions of the tribunal and communities across the State. By extrapolation, leaving the decision intact would have increased the number of appeals to the Court of Appeals, and potentially this Court. The Court of Appeals properly reversed, and made clear to the tribunal that in performing its duties it may not ignore the evidence, fail to acknowledge contradictory evidence, and value property that is not deed restricted as if it were restricted, and as if it were being used for a purpose other than the property's maximally productive legal use without properly accounting for the cost of alterations.

The tribunal's acceptance of the application of artificial and non-existent deed restrictions to the valuation of the property that is the subject of this case resulted in a substantially low value that did not represent what the property would have sold for on tax day. Does it make sense that a potential reasonable purchaser will ignore all of the potential uses to which the property could be put, and assume the use of the property will be restricted even though there are no deed restrictions of record, when determining how much to pay? When looking at a comparable property that had to be altered, would it make sense to ignore the extra costs that would be incurred subsequent to purchase? Would a reasonable mind in trying to determine how much to pay for the property not determine after purchase costs of the subject based on the cost approach and the particular attributes of the subject? A typical

[1] See *Thrifty Royal Oak, Inc v City of Royal Oak*, 208 Mich App 707, 712 (1995), where the Court took issue with a decision of the Tax Tribunal that deviated from established Michigan Tax Tribunal precedent.

reasonable purchaser would answer "no" to all. The tribunal violated the constitutional requirement that all property in the State of Michigan be uniformly assessed, and assessed at 50% of true cash value and was therefore, based on a wrong principle. The Court of Appeals properly reversed and remanded for findings consistent with law. The Appellant's Application for Leave to Appeal should be denied, and the decision of the Court of Appeals should be upheld.

COUNTER-STATEMENT OF FACTS

The *Amici* agree with and adopt by reference, and incorporate herein, the "Statement of Facts" set forth by the Appellee City of Escanaba in its Answer to the Application for Leave to Appeal. However, it is also important to discuss particular allegations of fact which were not properly brought forth by Appellant in its Statement of Facts with citation to the record or authority, but instead were introduced without authority and/or for the first time within the Argument section of the Application and/or which are inaccurate. In order to clarify what is, and what is not, part of the record, and what is correct and what is incorrect, *Amici* provide the following:

A. The result of the Court of Appeals decision is not a mandated use of the cost approach, and more importantly the decision does not require the "value in use" methodology which is relied upon by Appellant to create an issue which does not exist and which issue is further complicated by the lack of a supportive record.

The Appellant incorrectly claims on page 10 of the Application, that the Court of Appeals Opinion, "essentially mandates the cost approach (without appropriate deductions for obsolescence amounting to a value in use standard) for "big-box stores."" Appellant cites to page 9 of the Opinion. Page 9 of the Opinion does state, "the cost-less-depreciation approach is appropriate to value the [true cash value] of the property." However, it is completely devoid of the requirement that the cost-less-depreciation approach should be applied "without appropriate deductions for obsolescence" (a.k.a. depreciation). While the Court did determine that a cost-less-depreciation approach is suitable for this property for which there is a limited market (Op. 9-10), the conclusion of the Court presented on page 12 of the Opinion requires the tribunal to take additional evidence as to both the sales comparison approach and the cost-less-depreciation approach, and then, ""apply its expertise to the facts of the case in order to determine the appropriate method . . . " [Citation omitted].". By misstating the holding of the Court of Appeals, Appellant has created a false premise upon which to base its arguments.

Further, Appellant (also on page 10 of the application) inappropriately and without citation to authority for a definition (and the record itself is devoid of a discussion on this), posits the fiction that the Opinion mandates the use of the cost-less-depreciation approach without appropriate deductions and that this amounts "to a value in use standard". While the cases utilized and relied upon by the Court of Appeals do state that a property's existing use may be its highest and best use, there is nothing in the Court of Appeals Opinion and direction on remand which requires, as claimed within the Application, utilization of a cost-less-depreciation approach "without appropriate deductions for obsolescence", or which calls for a "value-in-use" methodology. *See* Application, p. 10. References to "value-in-use" are then peppered throughout Appellant's Application and appear to be the methodology about which Appellant is complaining, although this methodology was neither required nor directed to be used by the Court of Appeals.

Amici assert that the use of terms of art, that are similar, yet which carry different meanings, and which have not been adequately explained in the Application's Statement of Facts or in the Brief itself, should be viewed with extreme caution. As an example, the phrases "highest and best use", "value-in-use" or "use value", "market value", "market analysis" or "sales comparison approach" while using the same or similar terms can have very different meanings. Copies of pages from the treatise, *The Dictionary of Real Estate Appraisal*, Appraisal Institute, 6th Ed. (2015), defining these terms are attached hereto as Exhibit A. Appellant further compounds the terminology confusion by making the unsupported methodology claim on page 13 of the Application that, "functional obsolescence is inherently built into each business's building to fit its respective image and operating needs". At this point, this is a fictional premise not supported by the record in this case. In fact, the Court of Appeals noted on page 4 of its Opinion that Appellant's own expert appraiser, "did not, however, identify any specific features of the building that created functional obsolescence, nor did he identify any economic factors in the subject market that would account for external obsolescence." On remand, it would be expected that Appellant would be provided an opportunity to revisit this issue.

Appellant earlier in the same paragraph on page 13 of Application refers to an article, not attached to its brief, by David Charles Lennhoff for other definitions, which definitions while similar to those found in *Dictionary of Real Estate Appraisal,* they are not quite the same. *See* the definitions as contained within footnote 9, on page 13 of the Application. Caution is advised against relying on an opinion article which puts forth definitions contrary to *The Dictionary of Real Estate Appraisal*. As can be seen from the definitions contained with *The Dictionary of Real Estate Appraisal* for "functional obsolescence" and "external obsolescence" (Exhibits B and C hereto), while they may discuss similar subject matter to the Lennhoff definitions, the Lennhoff definitions are not the same as those agreed upon by the Appraisal Institute as being the proper definitions.

It is, however, worth noting that a prior article by the same author (Exhibit D hereto) on similar subject matter has had varying levels of acceptance and rebuke. Just in relation to this case, Exhibit D supports the Court of Appeals Opinion, or contains positions disregarded by all parties involved or just by the Appellant's own expert. As an example, it appears Lennhoff himself, like the Court of Appeals, would criticize Appellant's appraiser's sales comparables based upon what Lennhoff wrote (Exhibit D, page 62) in discussion of the sale of second generation properties like those utilized by the Appellant's appraiser:

> If these sales are not distress sales and share the same highest and best use as the subject if vacant and available to be leased,

> then they will provide credible evidence of the subject's market value. More times than not, however, ample transactions of this kind are not available and the appraiser is not able to use the sales comparison approach.

And contrary to Lennhoff's position on page 63 of his article (Exhibit D) that the, "application of the income capitalization approach is important", both sides agreed in this case that it was not. Op. page 2, n. 1. The point is that while any Lennhoff article may be a mildly relevant anecdote, reliance on a Lennhoff "theory" or "definition" must be viewed critically, and seen for what it is: an opinion article not contained within any recognized treatise pertaining to the valuation of real estate.

In sum, while the Appellant's Application for Leave to Appeal is replete with references to "value-in-use", and claims that the Court of Appeals has required a "value-in-use" methodology solely, this appears to simply be a fiction not utilized by the Court of Appeals below, not ordered to be utilized on remand to the tribunal, and only utilized within the Application in an attempt to create an issue where one does not exist.

B. The Appellant over simplifies and misstates the holding of the Court of Appeals in order to create an additional claim of appealable error.

On page 10 of the Application, the Appellant through the failure to fully discuss the holding of the Court of Appeals, over simplifies the Court of Appeals' reasoning by merely stating, "[t]he Court of Appeals concluded that the Tax Tribunal committed an error of law requiring reversal when it adopted the sales-comparison approach over the cost-less-depreciation approach, and remanded." Appellant cites to page 12 of the Opinion for this misrepresentative proposition. In actuality, the conclusion of the Court of Appeals is much more encompassing, as well as not nearly as severe. The Court of Appeals actually concluded that:

> [t]he tribunal committed an error of law requiring reversal when it rejected the cost-less-depreciation approach and adopted a sales-comparison approach that failed to fully account for the effect on the market of the deed restrictions in those comparables . . . [O]n remand, the tribunal shall take additional evidence with regard to the market effect of the deed restrictions. If the data is insufficient to reliably adjust the value of the comparable properties if sold for the subject property's [highest and best use], the comparables should not be used. The tribunal shall also allow the parties to submit additional evidence as to the cost-less-depreciation approach.

There was no wholesale rejection of the sales comparison approach as suggested by the Appellant. Nor was there a wholesale acceptance and directive to only use the cost-less-depreciation approach. And both parties have the opportunity to present more evidence as to each approach. Depending on what evidence Appellant introduces on remand, the tribunal may have sufficient information to utilize Appellant's sales comparables to value the subject property. Also depending on what evidence is introduced, the tribunal may also be able to utilize the cost-less-depreciation approach. The use of either approach, and whether either approach is eventually utilized, remains to be seen. The Court of Appeals has not mandated one use of one approach over another, and has simply remanded the case for the taking of additional evidence in order to have a record, which on the whole, could potentially support the tribunal's conclusions.

C. Other Problematic Statements

Three other incorrect or only partially correct factual statements were also made in the Application which should be cleared up so that these statements are not assigned more importance than what they are due. First, Appellant asserts that Judge Abood has been "a licensed and certified appraiser (since 1991)". Application p. 4. According to the State of Michigan Department of Licensing and Regulatory Affairs, ALJ Abood has held his Certified

General Real Estate Appraiser license since 2007. He became a Certified Residential Real Estate Appraiser in 2003, and he first became a State Licensed Real Estate Appraiser in 1991. See Exhibit E hereto. Further, ALJ Abood, as the appraiser member of the tribunal, is also not a licensed attorney.

Second, Appellant asserts that an, "MAI designation is the professional designation of the Appraisal Institute for appraisers experienced in the valuation and evaluation of all types of properties." Application page 4, footnote 3. Technically, and according to the Appraisal Institute, an MAI designation does not mean an appraiser is "experienced in the valuation and evaluation of all types of properties" and merely means that the holder is, "experienced in the valuation and evaluation of commercial, industrial, residential and other types of properties".[2] In other words, just because someone holds an MAI designation, does not mean that person holds a particular expertise in the valuation of any type of property, much less "all types". Third, the Appellant incorrectly claims that the City Assessor's valuation disclosure did not comply with Tax Tribunal Rule 237, and was not an actual valuation disclosure. Application, p 5. Not only was there no ruling to this effect from the Tribunal, the Tribunal accepted the valuation disclosure (Trial Exhibit R-9) into evidence. FOJ, p. 6. The Tribunal also found, as contained in its Findings of Fact on page 9 of the Final Opinion and Judgment, that: "40. Respondent submitted a valuation disclosure prepared by Diana Norden."

D. The Response to the Application for Leave to Appeal

The Appellee City of Escanaba has filed its Answer to the Application for Leave to Appeal asking that the Application be denied and the decision of the Court of Appeals be otherwise upheld. The *Amici* - Michigan Municipal League, Michigan Townships Association, Public

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[2] http://www.appraisalinstitute.org/designation-requirements/

Corporation Law Section of the State Bar of Michigan, and Michigan Association of Counties – as interested parties responsible providing essential services, and whose tax bases could be detrimentally and severely impacted should the decision of the tribunal be allowed to stand have joined in the support of the City of Escanaba's position supporting the decision of the Court of Appeals through the filing of this *Amicus Curiae* Brief.

STANDARD OF REVIEW

The factual determinations of the tribunal are binding upon an appellate court unless there is fraud, error of law or the adoption of a wrong principle.[3] A decision of the tribunal that is not supported by competent, material and substantial evidence is an error of law.[4] According to the State of Michigan Constitution, Mich Const 1963, art 6, § 28, the:

> review shall include, as a minimum, the determination whether such final decisions, findings, rulings and orders are authorized by law; and, in cases in which a hearing is required, whether the same are supported by competent, material and substantial evidence on the whole record.

Substantial evidence must be more than a scintilla of evidence, although it may be substantially less than a preponderance of the evidence.[5] The Tribunal's actions are reviewable for an abuse of discretion.[6] Failure to base a decision on competent, material, and substantial evidence constitutes an error of law requiring reversal.[7] Matters of statutory construction are decided *de novo*.[8]

Furthermore, substantial evidence "is that which a reasonable mind would accept as adequate to support a decision," and may be less than a preponderance of the evidence. *McBride v Pontiac School Dist (On Remand),* 218 Mich App 113, 123 (1996). "Under this test, it does not matter that the contrary position is supported by more evidence, that is, which way the evidence preponderates, but only whether the position adopted by the agency is supported by evidence from which legitimate and supportable inferences were drawn." *Id*. Where the

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[3] *Wolverine Tower Associates v City of Ann Arbor,* 96 Mich App 780 (1980); *Georgetown Place Cooperative v City of Taylor*, 226 Mich App 33, 43 (1997).
[4] *Connors & Mack Hamburgers, Inc v Michigan Department of Treasury*, 129 Mich App 627 (1983); *Georgetown Place Cooperative v City of Taylor*, *supra.*
[5] *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 352-353 (1992).
[6] *Stevens v Bangor Twp*, 150 Mich App 756 (1986).
[7] *Oldenberg v Dryden Twp*, 198 Mich App 696, 698 (1993).
[8] *Danse Corp v City of Madison Heights,* 466 Mich 175, 178 (2002).

Tribunal's findings are supported by competent, material, and substantial evidence, there is no basis to reverse. See *Comcast v Sterling Heights*, 218 Mich App 8, 11 (1996).

ARGUMENT

Basically, what is at issue in this case is whether the tribunal had competent, material and substantial evidence on the whole record upon which to base its decision, and whether the Court of Appeals was correct in remanding the matter back to the tribunal after finding that the tribunal did not. The Appellee City of Escanaba successfully appealed to the Court of Appeals the tribunal's decision which failed to properly account for the effect of deed restrictions on sales comparables utilized by the tribunal to value the property at issue. The tribunal decision, rendered by a non-attorney member of the tribunal, failed to consider the effect of deed restrictions which, for the most part, prevented the sales comparables from being utilized for the same use as the property being valued and then failed to apply its expertise in order to utilize a cost approach to value the property. The result was a significant reduction to the property's true cash, assessed and taxable values. The Court of Appeals correctly reversed the tribunal's decision and remanded matter back to the tribunal for additional findings.

The *Amicus Curiae* - Michigan Municipal League, Michigan Townships Association, Public Corporation Law Section of the State Bar of Michigan, and Michigan Association of Counties - have joined in the support of the City of Escanaba's Answer to the Application for Leave to Appeal. The potential widespread detrimental effect of the tribunal's decision (to reduce property values more than 50% based upon inapplicable deed restrictions and inappropriate highest and best uses) could have on the State's real property tax base – and as result the funding cuts which would be suffered by our schools, counties, and local governments - are substantial. The ability of our schools to educate our children, and our counties and local governments to provide essential services (such as police, fire, and safe roads), depends on a system of taxation that is premised on what the property under appeal would sell for at market rates and according to the property's highest and best use. *Amici* are greatly concerned about the potential effects of the continuation of the appeal of this case, and request that leave to appeal be denied and that the decision of the Court of Appeals be upheld.

It should be noted that Amici will discuss the issues raised by Appellant after a brief discussion as to taxation basics.

I. Discussion as to Taxation and Valuation Basics

Prior to discussing any of the issues it is important to discuss property taxation in general, and the accepted methodologies in Michigan for determining property value for taxation purposes. The assessment of real property in Michigan is governed by the constitutional standard that such property shall not be assessed in excess of 50% of its true cash value. The electorate of the State of Michigan adopted Section 3 of Article IX of the Michigan Constitution of 1963 which reads as follows:

> The legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law except for taxes levied for school operating purposes. The legislature shall provide for the determination of true cash value of such property; the proportion of true cash value at which such property shall be uniformly assessed, which shall not, after January 1, 1966, exceed 50 percent; and for a system of equalization of assessments. . . .

The Legislature, to fulfill its Constitutional duties, adopted MCL 211.27, which defines true cash value and states in its pertinent part that true cash value is:

> . . . the usual selling price at the place where the property to which the term is applied is at the time of assessment, being the price that could be obtained for the property at private sale, and

> not at auction sale except as otherwise provided in this section, or at forced sale. MCL 211.27(1).

The Michigan Supreme Court has stated that "'[t]rue cash value' is synonymous with 'fair market value'" while at the same time finding that a commonly utilized valuation approach does not result in true cash value because it failed to take into consideration the in-place lease which restricted income. *CAF Investment Co v State Tax Commission*, 392 Mich 442, 450, 465 (1974).

This brings us back to the statute and the need to consider the entirety of MCL 211.27(1) and (6) which read:

> (1) As used in this act, "true cash value" means the usual selling price at the place where the property to which the term is applied is at the time of assessment, being the price that could be obtained for the property at private sale, and not at auction sale except as otherwise provided in this section, or at forced sale. The usual selling price may include sales at public auction held by a nongovernmental agency or person if those sales have become a common method of acquisition in the jurisdiction for the class of property being valued. The usual selling price does not include sales at public auction if the sale is part of a liquidation of the seller's assets in a bankruptcy proceeding or if the seller is unable to use common marketing techniques to obtain the usual selling price for the property. A sale or other disposition by this state or an agency or political subdivision of this state of land acquired for delinquent taxes or an appraisal made in connection with the sale or other disposition or the value attributed to the property of regulated public utilities by a governmental regulatory agency for rate-making purposes is not controlling evidence of true cash value for assessment purposes. In determining the true cash value, the assessor shall also consider the advantages and disadvantages of location; quality of soil; zoning; existing use; present economic income of structures, including farm structures; present economic income of land if the land is being farmed or otherwise put to income producing use; quantity and value of standing timber; water power and privileges; minerals, quarries, or other valuable deposits not otherwise exempt under this act known to be available in the land and their value. In determining the true cash value of personal property owned by an electric utility cooperative, the assessor shall consider the number of kilowatt hours of electricity sold per mile of distribution line compared to the average number of kilowatt hours of electricity sold per mile of distribution line for all electric utilities.

> * * *(6) Except as otherwise provided in subsection (7), the purchase price paid in a transfer of property is not the presumptive true cash value of the property transferred. In determining the true cash value of transferred property, an assessing officer shall assess that property using the same valuation method used to value all other property of that same classification in the assessing jurisdiction. As used in this subsection and subsection (7), "purchase price" means the total consideration agreed to in an arms-length transaction and not at a forced sale paid by the purchaser of the property, stated in dollars, whether or not paid in dollars.

While the Legislature has defined "true cash value" and provided a laundry list of what should and should not be considered representative of true cash value, the interpretation of this section and the actual implementation of valuation has been set up by the Legislature to occur primarily in two stages: 1) Assessment through the General Property Tax Act, MCL 211.1, *et seq*.; and, 2) Appeals of the assessment to the Michigan Tax Tribunal, MCL 205.701, *et seq*. What has happened over the years is that a body of case law pertaining to proper valuation methodology has been developed stemming from appeals to the tribunal, and then the appeal of tribunal decisions to the Court of Appeals and the Supreme Court. The decision of the tribunal in this case was not supported by the record on the whole, and the Court of Appeals properly remanded it for the taking of more evidence.

A. Methods of Valuation

Generally speaking, there are three methods of true cash valuation for tax assessment purposes accepted by the Tribunal and the Courts. These methods were described in *Meadowlanes Ltd Dividend Housing Ass'n v Holland*, 437 Mich 473, 484-485 (1991) as:

> (1) the cost-less-depreciation approach,[FN18] (2) the sales-comparison or market approach,[FN19] and (3) the capitalization-of-income approach.[FN20] Variations of these approaches and entirely new methods may be useful if found to be accurate and reasonably related to the fair-market value of the subject property. *[Citation and footnote omitted].* It is the Tax Tribunal's duty to determine which approaches are useful in providing the most accurate valuation under the individual circumstances of

> each case. *[Citation omitted].* Regardless of the valuation approach employed, the final value determination must represent the usual price for which the subject property would sell. *[Citation omitted].*
>
> FN18. Under the cost approach, true cash value is derived by adding the estimated land value to an estimate of the current cost of reproducing or replacing improvements and then deducting the loss in value from depreciation in structures, i.e., physical deterioration and functional or economic obsolescence.
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> FN19. The sales-comparison approach indicates true cash value by analyzing recent sales of similar properties, comparing them with the subject property, and adjusting the sales price of the comparable properties to reflect differences between the two properties.
>
> FN20. The income-capitalization approach measures the present value of the future benefits of property ownership by estimating the property's income stream and its resale value (reversionary interests) and then developing a capitalization rate which is used to convert the estimated future benefits into a present lump-sum value.

In this case, the tribunal utilized the sales comparison approach, and refused to utilize the cost-less-depreciation approach, to value the property. The parties had agreed that the income approach was not applicable. In valuing the property utilizing the sales comparison approach, the tribunal failed in this approach to, "analyz[e] recent sales of similar properties, compar[e] them with the subject property, and adjust[] the sales price of the comparable properties to reflect differences between the two properties." *Id*. Particularly, the tribunal failed to account for how the existence deed restrictions on the sales comparables affected sales price, and failed to adjust the comparables for the effect. Because of these failures, the tribunal's value determination did not represent the usual price for which this non-deed restricted free standing retail store in Escanaba, Michigan would sell.

Further, while the tribunal was presented with sufficient information to utilize a cost-less-depreciation approach, the tribunal chose to ignore it and not utilize this approach to value a property that has limited market/sales comparables available. The Appellant would have the

Court believe that the remand in this case constitutes a mandate to utilize the cost-less-depreciation approach without the appropriate consideration of depreciation and/or obsolescences of the subject property. The Court of Appeals Opinion is devoid of this mandate, and it is presumed that the tribunal will follow the law and apply appropriate depreciation and obsolescence amounts based upon the evidence and testimony in the case. What should be considered and why in terms of obsolescence was explained in *Forest Hills Co-operative v City of Ann Arbor*, 305 Mich App 572, 590-91, *appeal denied sub nom. Forest Hills Co-op v City of Ann Arbor*, 497 Mich 948 (2014), where the Court wrote:

> Functional obsolescence refers to "a loss of value brought about by failure or inability of the assessed property to provide full utility." *Meijer, Inc v City of Midland,* 240 Mich App 1, 4 n. 4 (2000). For instance, a poor floor plan can cause functional obsolescence, although it is possible that the use of a replacement-cost approach might eliminate the need to consider some sources of functional obsolescence. *Teledyne Continental Motors v Muskegon Twp,* 145 Mich App 749, 755–756 (1985). Economic obsolescence refers to a "loss of value occasioned by outside forces." *Fisher–New Ctr Co v State Tax Comm,* 380 Mich 340, 362 (1968), vacated on other grounds on reh. 381 Mich 713 (1969). The measure of allowable obsolescence is a subjective determination that demands an exercise of judgment. *Fisher–New Ctr,* 380 Mich at 362–363. "Even a slight variation in the percentage of depreciation or of obsolescence may produce a considerable difference in valuation." *Id.* at 369.
>
> In *Meadowlanes,* 437 Mich at 503, the Supreme Court indicated that when using the cost-less-depreciation approach, economic obsolescence should be calculated in light of the property's highest and best use. [footnote omitted].

The remand in this case is necessary because there was insufficient testimony as to obsolesence.

B. Conclusion

The Court of Appeals correctly determined that the case should be remanded back to the tribunal for additional findings which would support a decision based upon the whole record as to value utilizing either the sales comparison approach, and/or the cost-less-depreciation approach.

II. The Court should deny Appellant's Application for Leave to Appeal, and/or affirm the decision of the Court of Appeals requiring a remand to the Michigan Tax Tribunal to more fully develop the record, where the Appellant has not raised an issue involving legal principles of major legal significance to the state's jurisprudence where the issues are premised on a fiction, and which, therefore, are also technically not an appeal of the decision of the Court of Appeals where the Appellant wrongfully claims the Court of Appeals has required a value-in-use valuation by the tribunal and mandated a cost-less-depreciation valuation where the language of the Opinion states otherwise, and where the case law relied upon by the Court of Appeals, contrary to the averments of Appellant, is valid and should be followed.

A. Introduction

Appellant, in its Application for leave to Appeal, improperly attempts to create an issue for appeal by incorrectly claiming that a case referred to by the Court of Appeals in its Opinion is questionable, and that this somehow translates to a mandated impermissible valuation methodology; while at same time failing to acknowledge that at the tribunal, it was the Appellant property owner, and not the Appellee city, which had the burden of proof. The creation of an issue where there really is not one does not rise to the level of a matter involving legal principles of major legal significance to the state's jurisprudence. Because of this, the Application for Leave to Appeal should be denied.

B. Standard of Review

The factual determinations of the Tribunal are binding upon an appellate court unless there is fraud, error of law or the adoption of a wrong principle.[9] A decision of the Tribunal that

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[9] *Wolverine Tower Associates v City of Ann Arbor,* 96 Mich App 780 (1980); *Georgetown Place Cooperative v City of Taylor*, 226 Mich App 33, 43 (1997).

is not supported by competent, material and substantial evidence is an error of law.[10] Substantial evidence must be more than a scintilla of evidence, although it may be substantially less than a preponderance of the evidence.[11] The Tribunal's actions are reviewable for an abuse of discretion.[12] Failure to base a decision on competent, material, and substantial evidence constitutes an error of law requiring reversal.[13] Matters of statutory construction are decided *de novo*.[14]

Furthermore, substantial evidence "is that which a reasonable mind would accept as adequate to support a decision," and may be less than a preponderance of the evidence. *McBride v Pontiac School Dist (On Remand),* 218 Mich App 113, 123 (1996). "Under this test, it does not matter that the contrary position is supported by more evidence, that is, which way the evidence preponderates, but only whether the position adopted by the agency is supported by evidence from which legitimate and supportable inferences were drawn." *Id*.

C. Discussion

In the State of Michigan, and as discussed in the previous section of this Brief, there is more than one way to value property for taxation purposes, and despite what Appellant claims, a derogation of a sales comparison approach relying on sales of properties with different highest and best uses than the subject property is not one of them. The Appellant would also have this Court incorrectly believe that a cost-less-depreciation approach to value property is impermissible. To this end, Appellant provides a misinterpretation of the holdings in *Clark Equip Co v Leoni Twp,* 113 Mich App 778, 783 (1982), and the cases that follow it, while at the same time failing to inform the Court of more recent decisions upholding a cost-less-depreciation

[10] *Connors & Mack Hamburgers, Inc v Michigan Department of Treasury*, 129 Mich App 627 (1983); *Georgetown Place Cooperative v City of Taylor*, *supra.*
[11] *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 352-353 (1992).
[12] *Stevens v Bangor Twp*, 150 Mich App 756 (1986).
[13] *Oldenberg v Dryden Twp*, 198 Mich App 696, 698 (1993).
[14] *Danse Corp v City of Madison Heights,* 466 Mich 175, 178 (2002).

approach. *See, e.g., Detroit Lions, Inc v City of Dearborn*, 302 Mich App 676, 697 (2013); *app dn'd,* 495 Mich 948 (2014).

1. The decision in Clark is still good and First Federal did not overrule it.

In the late 1970s and early 1980s, there were several tax cases involving the valuation of large industrial properties. In those cases, the tribunal and courts struggled with how to value industrial property that either may not have a potential buyer, because it was so obsolete, or alternatively was not obsolete – but the market for a property with that particular use was very limited. The former situation was presented in *Safran Printing Co v Detroit,* 88 Mich App 376 (1979), *lv den* 411 Mich 880 (1981), which determined that a "value-in-use" approach was appropriate. The latter situation – which is more similar to the case at hand - was discussed in *Clark Equip Co v Leoni Twp,* 113 Mich App 778 (1982).

In *Clark*, the court had to determine whether it was appropriate to utilize the sales comparison approach or the cost approach to value the property where, similar to the property at issue in this case, the property's highest and best use is its current use but the particular type of property was rarely traded on the open market. In this case, the Appellant's appraiser presented nearly no non-deed restricted sales that sold for the same intended use as the subject property, proving the point. The reality is that, as the subject sat on tax day - without deed restrictions and with its highest and best use as its existing use - a retail company would not sell the property unless the company was under financial duress, because to do so would not protect its position in the market.

As explained in *Clark* at 782-783:

> In this case, we are confronted with a factual scenario quite different than that posed by *Safran.* Unlike the situation in *Safran*, all the appraisers in this case agreed that the subject property's current use is also its highest and best use. Indeed, petitioner's appraiser's market analysis report includes the following statement:

> "The subject property was originally designed as a manufacturing plant and has been used for this purpose continuously since its conception. Although it has several obsolete design features, it is still modern enough to be considered for continued use for an industrial purpose. Moreover, it is currently occupied and used as an industrial plant and its owner-occupant has expressed no desire to abandon the property even though recent adjustments have been made in employee levels and product lines. Based upon the consistency of use exhibited by the above factors, the subject's highest and best use was estimated to be consistent with its current use as a manufacturing plant."

> Contrary to petitioner's apparent contention, the Court in *Safran* did not hold that a cost analysis based on value in use could never be used to determine usual selling price. The *Safran* Court specifically noted that "existing use may be indicative of the use to which a potential buyer would put the property and is, therefore, relevant to the fair market value of the property". *Id.*, 382.

The court went on to explain at 784-785:

> The problem with valuing large industrial plants is a problem with the statutory standard itself. The reality is that these types of industrial plants are rarely bought and sold, so that a determination of "usual selling price" constitutes a metaphysical exercise which puts the Tax Tribunal in the position of having to resolve a question somewhat akin to how many angels can dance on the head of a pin. Petitioner may well be correct in its assertion that there is no market for its industrial plant at its current use. However, as we construe MCL § 211.27, to the extent that an industrial plant is not so obsolete that, if a potential buyer did exist who was searching for an industrial property to perform the functions currently performed in the subject plant, said buyer would consider purchasing the subject property, the usual selling price can be based upon value in use. To apply MCL § 211.27, a hypothetical buyer must be posited, although, in actuality, such a buyer may not exist. To construe MCL § 211.27 as requiring the taxing unit to prove an *actual* market for a property's existing use would lead to absurd under valuations.

And that is exactly what happened here in the tribunal. Requiring the property to be valued utilizing the market approach led to "absurd undervaluation".

Contrary to that claimed by Appellant, the holdings in *Clark* applicable to this case are still good and were not overruled by *First Federal Sav & Loan Ass'n of Flint v City of Flint*, 415 Mich 702 (1982). Instead of invalidating the *Clark* case holding as claimed by Appellant, the *First Federal* case, in actuality, only added to the considerations to be employed when using the cost-less-depreciation approach to value property. In *First Federal*, a bank building had enhancements only meant to improve the owner's image and which may not have any value to a subsequent purchaser. The *First Federal* Court explained at 706–07:

> We do not hold that the income approach advocated by First Federal's appraiser should govern, nor do we fault the city's appraiser or the Tax Tribunal for *considering* historical cost. Rather, we reject the notion that it is proper to include, in determining value, expenditures made, as the Tax Tribunal found, to enhance plaintiff's image and business without regard to whether they add to the selling price of the building.
>
> Absent more persuasive evidence, such as comparable sales, historical cost or reproduction cost can be considered in arriving at the usual selling price, but historical or reproduction cost that merely enhances image or business but not selling price is not subject to taxation.

Basically, under *First Federal*, the cost-less-depreciation approach is still a valid methodology and "can be considered in arriving at the usual selling price" provided it does not include costs for items which enhance business image and not the selling price.

2. *Even in Clark, the tribunal applied a depreciation factor in the cost-less-depreciation approach.*

In this case, the Appellant incorrectly argues that the *Clark* case and its holdings have been overruled to the extent that a cost approach should not have been ordered to be employed on remand. Notably, on page 12 of the Application, Appellant makes broad assertions as to the meaning of "value in use" and then makes the statement, without reference to the record or cited authority that, "[t]his is harmonious with Michigan's requirement that property be assessed at its true cash value, established as a market value, not value to the owner." Appellant appears to claim the decision in *Clark* at page 785 authorized a value "utilizing a value in use standard". However, even in *Clark*, the tribunal applied a 40% depreciation factor to the property, which caused the *Clark* court to order a remand for the taking of sufficient evidence to support the 40%. *Clark* at 787. Because of this, the premise upon which the Application for Leave to Appeal (that *Clark* has been over-ruled and/or utilizes an impermissible cost-less-depreciation approach which applies no depreciation (a.k.a. "value in use") is based is untrue, and the Application should be denied.

3. The Appellant misconstrues the Opinion of the Court of Appeals and fails to inform the Court of current case law contrary to its position that real property in the State of Michigan should only be valued utilizing the sales comparison approach and cannot be valued utilizing the cost-less-depreciation methodology.

Another major problem with the Application is that it is based on a misunderstanding or a misrepresentation of the Opinion of the Court of Appeals. Appellant incorrectly claims the Court of Appeals in its Opinion, "essentially adopted a blanket cost methodology (i.e., value in use) for "big box stores", and other commercial and industrial properties. . . . such properties can no longer be assessed based on comparable sales . . .". Application p. 17. How Appellant has managed to extrapolate this conclusion from an Opinion that orders a remand for the taking of further evidence and the requirement of further consideration as to both the sales comparison approach and the cost-less-depreciation approach is baffling. That said, it should also be made clear that Appellant has provided no authority which supports the ill-founded proposition that it is no longer, or should no longer be, permissible to utilize a cost-less-depreciation approach as described by this Court in *Meadowlanes Ltd Dividend Housing Ass'n v Holland*, 437 Mich 473, 484-485 (1991), or that such an approach, by default, is an improper value in exchange methodology.

What is apparent is that in making this argument Appellant seems to forget, or at least fails to fully advise, that the sales comparables utilized by Appellant's appraiser were problematic because the comparables themselves did not have the same highest and best use as the property being valued. In essence, they were different types of properties and these differences needed to be quantified through adjustment to the individual sales prices of the comparables. Instead, we are treated to a long explanation as to how properties with restrictions preventing them from being used for the subject's current use, were still valid comparables. As a part of this argument, Appellant again makes unsupported allegations that the restrictions "have no practical effect" (Application p. 17), because "adult clubs" are prohibited by zoning ordinances, and discount stores are mostly under 50,000 square feet. While minimally salacious, these allegations of fact are not supported by the record in this case. It is incongruous that Appellant wants these facts considered by this Court but at the same time is fighting to not have them considered by the tribunal. If the Appellant wants to argue the effect of sexually oriented business zoning ordinances or the typical size of a discount store in relation to deed restrictions, Appellant should consent to a denial of its Application so the case can proceed on remand to the tribunal.

Further, what concerns *Amici* is the attempt by Appellant to argue falsely that the decision of the Court of Appeals amounts to a requirement that properties be valued according to value in use, as opposed to value in exchange, and that based on this false representation of the Opinion of the Court of Appeals, the Court of Appeals should be reversed. Appellant goes as far as to rely on an unpublished non-precedential decision of the Court of Appeals from 2014. This should be ignored because: 1) This is not what the Court of Appeals Opinion in this case states; and 2) As explained in another recent published decision, considering the existing use of a property is relevant to value and is permissible. In *Detroit Lions, Inc v City of*

Dearborn, 302 Mich App 676, 697 (2013); *app dn'd,* 495 Mich 948 (2014), the property owner argued in part, "that the tribunal committed legal error by concluding that the highest and best use of the property as improved was its existing use as a practice facility." The court disagreed, finding:

> [E]xisting use may be indicative of the use to which a potential buyer would put the property and is, therefore, relevant to the fair market value of the property. [Citations and internal quotations omitted].

Id. In *Detroit Lions*, the Petitioner had argued that instead of being valued as an National Football League Practice Facility and Team Headquarters, the subject of the appeal should be valued utilizing alternative highest and best uses that were either not permitted under the zoning laws, or like this case, that substantially decreased the property's value and, "therefore "violate[d] the princip[les] of highest and best use." *Id*.

The *Detroit Lions* court determined that the tribunal had sufficient evidence that the, "use of the property as an integrated professional football team headquarters and practice facility was the most profitable use to which the property could feasibly be put.". *Id.* at 698. *Amici* assert that the tribunal in this case likewise had sufficient evidence that the use of the property as a freestanding retail store **without** deed restrictions was the property's highest and best use, just based upon Petitioner's own expert's highest and best use conclusion. The tribunal failed to value the property accordingly and instead confounded the issue by valuing the property utilizing sales comparables that by law could not be utilized in the same manner or for the same purpose as the subject property due to deed restrictions.

Specifically, whether a property should be valued utilizing its current use as a basis for valuation was considered in the *Detroit Lions* case. The court, at 698-699, explained:

> We recognize that the MTT may not determine a property's true cash value solely on the basis of its current use "where such use bears no relationship to what a likely buyer would pay for the

> property[.]" *Safran,* 88 Mich App at 382. However, the *Safran* Court did not hold that a property's existing use could never be used to determine its usual selling price. *Clark Equip Co v Leoni Twp,* 113 Mich App 778, 783 (1982). In *Safran,* 88 Mich App at 382, the property was being used as a printing plant, even though this use was obsolete and it was undisputed that no buyer would purchase the property for this purpose. Accordingly, the property's existing use was not its highest and best use. *Id.* In the present case, conversely, the MTT's valuations were based on record evidence tending to show what a likely buyer would pay for the property. There was competent, material, and substantial evidence on the whole record to support the tribunal's determination that the practice facility's existing use was its highest and best use. See *Great Lakes Div of Nat'l Steel Corp v Ecorse,* 227 Mich App 379, 408 (1998). [footnote omitted]. Consequently, the tribunal properly considered the practice facility's existing use in determining its usual selling price. See *id.*

In this case, Petitioner's own appraisal, Ex. P-1, p34, stated that the highest and best use of the subject property "is concluded to be for continued use of the existing improvements as a free-standing retail building use." The Court of Appeals recognized this and remanded the case to the tribunal for an independent determination as to the applicability of the comparables and whether any adjustments should have been applied to account for the deed restrictions, as well as further review and application of the cost-less-depreciation approach. Both approaches are permissible and applicable to the subject property under the law.

D. Conclusion

The decision in *Clark* is still valid precedent and applies to this case. The claim that somehow the *Clark* decision does not employ a proper cost-less-depreciation methodology that does not account for depreciation is belied by the fact that even in *Clark* the tribunal applied a substantial depreciation factor. Further, more recent decision of the courts have continued to utilize the cost-less-depreciation method where the property's existing use is also its highest and best use, and there are insufficient appropriate sales comparables. Since this case has yet to be remanded for a determination as to whether the sales comparables can be adjusted and appropriately utilized, the claim the Court of Appeals has somehow mandated a cost-less-depreciation method is premature and untrue. The holdings in *Clark* are applicable to this case and it was not error for the Court of Appeals to rely upon them.

III. The Court should deny Appellant's Application for Leave to Appeal, and/or affirm the decision of the Court of Appeals decision requiring a remand to the Michigan Tax Tribunal to more fully develop the record, where the decision of the Court of Appeals does not cause material injustice and is in concert with prior decisions of the Courts, and where the Court of Appeals ordered a remand of the case to the tribunal so that the tribunal, and not the Court of Appeals, can take sufficient evidence under the law to support its decision, which allows all parties to make additional arguments, and where the weighing of that evidence is still left to the tribunal.

A. Introduction

The Application for Leave to Appeal should be denied and this case should be remanded to the tribunal. After examining the whole record, the Court of Appeals determined that an error of law requiring reversal had occurred where the tribunal rejected with little to no consideration the cost-less-depreciation approach, and "adopted a sales-comparison approach that failed to fully account for the effect on the market of deed restrictions in those comparables." Opinion, p. 12. The Court of Appeals did not substitute its weighing of the evidence as claimed by Appellant; rather the Court of Appeals called out errors of law consistent with prior decisions, and which did not cause material injustice. The Application for Leave to Appeal should be denied.

B. Standard of Review

The factual determinations of the Tribunal are binding upon an appellate court unless there is fraud, error of law or the adoption of a wrong principle.[15] A decision of the Tribunal

[15] *Wolverine Tower Associates v City of Ann Arbor,* 96 Mich App 780 (1980); *Georgetown Place Cooperative v City of Taylor*, 226 Mich App 33, 43 (1997).

that is not supported by competent, material and substantial evidence is an error of law.[16] Substantial evidence must be more than a scintilla of evidence, although it may be substantially less than a preponderance of the evidence.[17] The Tribunal's actions are reviewable for an abuse of discretion.[18] Failure to base a decision on competent, material, and substantial evidence constitutes an error of law requiring reversal.[19] Matters of statutory construction are decided *de novo*.[20]

Furthermore, substantial evidence "is that which a reasonable mind would accept as adequate to support a decision," and may be less than a preponderance of the evidence. *McBride v Pontiac School Dist (On Remand),* 218 Mich App 113, 123 (1996). "Under this test, it does not matter that the contrary position is supported by more evidence, that is, which way the evidence preponderates, but only whether the position adopted by the agency is supported by evidence from which legitimate and supportable inferences were drawn." *Id*.

C. Discussion

The decision of the Court of Appeals does not cause a material injustice where the case has been remanded to the tribunal for the taking of additional evidence, and where the final determination of which valuation approach to be utilized is still left to the tribunal. Appellant complains the Court of Appeals improperly substituted its judgment for that of the tribunal's. This is untrue. The Court of Appeals was correct in ordering a remand so that the tribunal can obtain sufficient evidence upon which to render an opinion which complies with the law.

1. *The Court of Appeals decision to remand for the taking of more evidence as to the effect of the deed restrictions on the sales comparables, corrects an*

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[16] *Connors & Mack Hamburgers, Inc v Michigan Department of Treasury*, 129 Mich App 627 (1983); *Georgetown Place Cooperative v City of Taylor*, *supra.*
[17] *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 352-353 (1992).
[18] *Stevens v Bangor Twp*, 150 Mich App 756 (1986).
[19] *Oldenberg v Dryden Twp*, 198 Mich App 696, 698 (1993).
[20] *Danse Corp v City of Madison Heights,* 466 Mich 175, 178 (2002).

> *error of law and is not an impermissible substitution of the tribunal's weight and credibility determinations.*

When reviewing the whole record, it becomes evident that the legal effects of the deed restrictions were not properly considered by the tribunal. This, as properly determined by the Court of Appeals, is an error of law. The effect of deeds restrictions on property values has been recognized by the courts of this state, and should have been recognized by the tribunal. The Court of Appeals did not impermissibly substitute its judgment for that of the tribunal where it appeared from the tribunal's decision that the non-lawyer ALJ either may not have fully considered or understood the implications of deed restrictions on the sales comparables. The Court of Appeals was correct in remanding the matter for a development of a record which properly addressed the deed restrictions.

Deed restrictions need to be properly considered because they do affect the value of a property, and they must be properly adjusted for if a sales comparable is subject to one or more of them. As explained in *Kensington Hills Development Co v Milford Twp,* 10 Mich App 368, 372 (1968), where the Court compared zoning restrictions to deed restrictions:

> Zoning restrictions are real and, during their duration, limit the use of the property as much as deed restrictions. Just as it is error to fail to consider deed restrictions in establishing assessments, [citation omitted], it is error to assess noncommercial property on the proposition that it will ultimately be zoned commercially.

As later explained in this Court's 1984 decision in *Antisdale v City of Galesburg*, 420 Mich 265, 285 (1984):

> Tax benefits, like deed restrictions, *Helin v Grosse Pointe Twp,* 329 Mich 396 (1951), and zoning classifications, *Kensington Hills Development Co v Milford Twp.,* 10 Mich App 368 (1968), of course, are not real property. Nevertheless, such incorporeal items, not taxable in and of themselves, can increase or decrease the value of real property, and that amount should be reflected in the assessment process.

The *Antisdale* Court stated it plainly, and the law has not changed.

Requiring compliance with the law in rendering a tribunal decision on remand does not amount to material injustice to the Appellant such that this Court should grant the Application for Leave to Appeal. In this case, the Court of Appeals recognized that the tribunal did not follow the law when weighing the comparables utilized by the Appellant, and instead rested on a verbal explanation from Appellant's appraiser (that did not address what the deed restrictions were and how they individually did or did not affect the sale price of the comparables) that the deed restrictions had no effect. Had each of the comparables had the exact same restriction, and if that restriction could have been easily weighed, then perhaps the tribunal's reliance on the appraiser's statement would have passed muster. But where the comparables were differently restricted, there should have been an analysis as to how each of the deed restrictions affected the value of each of the sales comparables. To say that absolutely none of the deed restrictions affected value is contrary to what a reasonable mind would find to be sufficient and is not competent, substantial and material evidence. In fact, saying that the deed restrictions did not affect the sales prices of the comparables is contradictory to the Appellant's own evidence, because the two sales that had the highest per square foot values were the two sales that did not have deed restrictions. The failure to properly analyze the comparables is an error of law, and the Court of Appeals was correct in requiring reversal and remand.

Furthermore, as explained in *Detroit Lions, Inc v City of Dearborn*, 302 Mich App 676, 697 (2013) *app den*, 495 Mich 948 (2014):

> The concept of "highest and best use" is fundamental to the determination of true cash value. See *Detroit/Wayne Co Stadium Auth v Drinkwater, Taylor & Merrill, Inc,* 267 Mich App 625, 633 (2005). " 'Highest and best use' means 'the most profitable and advantageous use the owner may make of the property even if the property is presently used for a different purpose or is vacant, so long as there is a market demand for such use.' " *Id.* at 633 (citation omitted). A highest and best use determination "requires simply that the use be legally permissible, financially feasible, maximally productive, and physically possible." *Detroit v Detroit*

> *Plaza Ltd Partnership,* 273 Mich App 260, 285 (2006). **"[I]t is the duty of the tribunal to hypothesize the highest probable price at which a sale would take place."** *Safran Printing Co v Detroit,* 88 Mich App 376, 382 (1979). "[E]xisting use may be indicative of the use to which a potential buyer would put the property and is, therefore, relevant to the fair market value of the property." *Id.* [Emphasis added].

The tribunal in this case utterly failed to value the subject property at its "highest probable price" when it used sales of deed restricted properties purchased for uses other than the subject's current (and maximally productive) use without adjusting those sales prices upward to compensate for their deficiencies. In essence, instead of determining the "highest" probable price, the tribunal actually determined the "**lowest**" probable price that could be obtained - assuming without support that the Escanaba retail property market was as depressed as the 400 miles away Detroit area, and that the property would be treated as though it were subject to non-existent deed restrictions that would prevent the full range of retail uses or would sell for use as something other than a retail use.

As stated in *Great Lakes Div of Nat Steel Corp v City of Ecorse*, 227 Mich App 379, 391 (1998):

> The sales-comparison or market approach has been described as requiring an analysis of recent sales of similar properties, a comparison of the sales with the subject property, and adjustments to the sale prices of the comparable properties to reflect differences between the properties. [Citation Omitted]. It has been described as the only approach that directly reflects the balance of supply and demand for property in marketplace trading. [Citation Omitted]. However, if the analysis of a comparable sale is flawed, the valuation for the subject property is also flawed. [Citation omitted].

In this case, the analysis of the comparables was hopelessly flawed because the differences as to the legally permitted uses for each of the comparables, and the intended uses of the comparables, were not considered as factors in weighing their applicability to the subject. The tribunal, in reaching its value determination, should have utilized comparables with the same highest and best use as the subject in order to determine the highest and best use of the subject, or somehow adjusted for the deed restrictions or alternative uses to which Appellant's comparables had or were put. Instead, the tribunal shied away from doing the work necessary to come to a true cash value of the property based on a misconception that somehow it was acceptable to not value the property according to its current use. By utilizing comparables that were deed restricted, purchased for another use, or otherwise not used as a free-standing retail building, the tribunal did not value the property at its highest and best use and committed an error of law requiring reversal by the Court of Appeals.

Appellant argues that the remand is tantamount to the Court of Appeals making improper weight and credibility judgments as to the witnesses. *Amici* disagree. The factual determinations of the tribunal are binding upon an appellate court unless there is fraud, error of law or the adoption of a wrong principle.[21] A decision of the tribunal that is not supported by competent, material and substantial evidence is an error of law.[22] According to the State of Michigan Constitution, Mich Const 1963, art 6, § 28, the:

> review shall include, as a minimum, the determination whether such final decisions, findings, rulings and orders are authorized by law; and, in cases in which a hearing is required, whether the same are supported by competent, material and substantial evidence on the whole record.

In this case, the tribunal's decision which failed to properly address the deed restrictions was an error of law, and based upon a review of the "whole" record, it was evident that the tribunal failed to acknowledge that the preponderance of the evidence called into significant question the use of low-ball deed restricted sales to value the non-deed restricted subject property. These were errors of law which required reversal and remand. Contrary to that as asserted by

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[21] *Wolverine Tower Associates v City of Ann Arbor,* 96 Mich App 780 (1980); *Georgetown Place Cooperative v City of Taylor*, 226 Mich App 33, 43 (1997).

[22] *Connors & Mack Hamburgers, Inc v Michigan Department of Treasury*, 129 Mich App 627 (1983); *Georgetown Place Cooperative v City of Taylor*, *supra.*

Appellant, the decision of the Court of Appeals requiring so is not clearly erroneous, does not cause material injustice and does not conflict other decisions of the courts.

2. *It was not error, or a substitution of the tribunal's judgment to also order the consideration of the cost-less-depreciation approach on remand.*

It has long been held that multiple valuation methods should be utilized to value property when possible. *Meadowlanes*, *supra*. at 485. Not to do so where possible, or as in this case to even refuse to consider to do so, is an error of law. The tribunal had available to it evidence to support a cost-less-depreciation approach, but failed to consider it. If, on remand it is determined that there is no actual market for the property as it sits, and/or the only market comparables are either deed restricted or sold for a differing highest and best use for which appropriate adjustments cannot be made, then the cost-less-depreciation approach will have to be utilized. If it is determined that the sales comparison approach can be used, then the cost-less-depreciation approach should still be considered, if for no other reason than as a check against the value determined utilizing the sales comparison approach.

Again, the subject here is not unlike the large industrial plants. The *Clark* court explained at 785:

> Large industrial plants are constructed to order, in accordance with the exact specifications of the purchasing user. Such plants are not constructed like small commercial buildings or residential structures with only a mere hope or expectation on the builder's part that the plant will be sold. When a large corporate entity such as Ford or General Motors builds a factory, it is probable that absolutely no market exists for the resale of that factory consistent with its current use. It is ludicrous to conclude, however, that such a brand new, modern, industrial facility is worth significantly less than represented by its replacement cost premised on value in use because, in actuality, such industrial facilities are rarely bought and sold.

The court explained that, when valuing a property as if a purchaser would want to use the property in accordance with its current use and according to its current capabilities, sustaining the assessment [which is a cost approach based upon the property as it sits – and is not a "cost on the open market" approach] is not error, because "the subject property here remains suited to its particular use and is not obsolete.". *Id.* at 785-786. Whereas here, the sales comparables presented at trial were deed restricted, sold under duress, or sold for a differing highest and best use, and our subject property is a non-deed restricted property not under duress, with a current use that is its highest and best use, the tribunal should have endeavored to explore and utilize the cost-less-depreciation approach to value the property. The Court of Appeals did not substitute its judgment for that of the tribunal when it called the tribunal out for this error of law, and remanded the case so that the tribunal, in accordance with *Meadowlanes*, could utilize more than one approach which could then be specifically tailored to the subject property's obsolescences.

Additionally, remand was appropriate in this case because it was an error of law for the tribunal to improperly shift the burden onto the City as to obsolescence factors, and it is not a material injustice to Appellant or contrary to other decisions of the courts to require the tribunal to consider a cost-less-depreciation approach which by its plain meaning requires the consideration of depreciation. The tribunal below improperly rejected Escanaba's cost-less-depreciation approach, finding that it had failed to account for functional obsolescence without specifically calling out what those functional obsolescences were. FOJ, p13. This is contrary to *Clark*. When the property's highest and best use is its current use, the tribunal should have valued the property as if it would be used for that use and not required a "cost on the open market" approach. The tribunal essentially, and inappropriately, placed the burden of proof on the City of Escanaba to show what the "obsolescences" were, and therefore the amount of depreciation which should have been employed.

Conversely, by not presenting specific evidence as to what was wrong or how much of a deduction should have been made to Escanaba's cost approach, the tribunal should have found that Appellant had conceded the issue of the amount of obsolescence/depreciation. In *Clark* at 787, the court wrote:

> We recognize that the petitioner has the burden of proving true cash value, MCL § 205.737(3), and that, here, petitioner presented no evidence of an appropriate depreciation rate, relying solely on a market analysis to the valuation problem. In our opinion, however, all this constitutes is a concession that, if the respondent's cost analysis be adopted by the tribunal, petitioner does not claim error in the depreciation factor respondent's appraiser has found to be applicable.

The Tribunal adopted a wrong principle by not using a cost approach to value the property, and the decision was correctly reversed as an error of law.

D. Conclusion

The Court of Appeals properly determined that this case should be remanded for the taking of more testimony and evidence as to the effect of the deed restrictions, as well as for the consideration of the cost-less-depreciation approach. To do so was not an impermissible substitution of the tribunal's weight of the evidence determinations when the tribunal's determinations were not based upon the record as a whole and thereby constituted an error of law. Requiring the tribunal to look at the whole record and take additional evidence to support the tribunal's determinations does not cause material injustice and is consistent with the other decisions of the courts.

CONCLUSION

This case was properly reversed and remanded by the Court of Appeals. The record is replete with contradictory evidence that the tribunal did not consider. Specifically, the tribunal inadequately addressed the effect of deed restrictions on, and alternative highest and best uses of, the sales comparables, and the entirely ignored evidence submitted by City of Escanaba. The tribunal further failed to value the property according to its highest and best use, and also failed to apply its own expertise to properly value the property utilizing the cost-less-depreciation approach. All of this lead to the "absurd undervaluation" of the subject property, which is of great concern because of the impact the decision may have had on subsequent determinations by the tribunal if the decision had been allowed to stand. For these reasons, *Amici* request that this Court uphold the decision of the Court of Appeals and/or deny the Application for Leave to Appeal.

Respectfully Submitted,

JOHNSON ROSATI SCHULTZ & JOPPICH, PC

/s/Stephanie Simon Morita
____
By: Stephanie Simon Morita (P53864)
Attorneys for Michigan Municipal
League *et al.*
27555 Executive Drive, Suite 250
Farmington Hills, MI 48331
(248) 489-4100

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EXHIBIT A

Appraisal Institute®

Professionals Providing Real Estate Solutions

The Dictionary of Real Estate Appraisal

6th edition

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The Appraisal Institute advances global standards, methodologies, and practices through the professional development of property economics worldwide.

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or market area that exhibits a wide variety of improvements, land uses, or inhabitants. *See also* **homogeneous.**

highest and best use

1. The reasonably probable use of property that results in the highest value. The four criteria that the highest and best use must meet are legal permissibility, physical possibility, financial feasibility, and maximum productivity.
2. The use of an asset that maximizes its potential and that is possible, legally permissible, and financially feasible. The highest and best use may be for continuation of an asset's existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid. (IVS)
3. [The] highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future. (Uniform Appraisal Standards for Federal Land Acquisitions)

high rise

1. A multistory building with elevators. Though sometimes defined as a building with ten or more stories, the definition may vary depending on locale and property type. When used in regard to office buildings in an urban setting, a building containing forty or more stories. (IREM)
2. In a central business district, a building higher than twenty-five stories above ground level; in suburban submarkets, generally a building higher than seven or eight stories. (SIOR)

See also **high-rise office building; low-rise; mid-rise.**

high-rise apartment building. An imprecise term used since World War II to distinguish a modern elevator apartment building from its prewar counterpart; usually a tall building, but this standard varies in different areas.

high-rise office building

1. A multistory office building, usually having sixteen floors or more.
2. A building of higher than twenty-five stories above ground level. (BOMA/NAIOP)

See also **low-rise office building; mid-rise office building.**

high-tech manufacturing facility. An industrial complex designed to meet the needs of high technology fabrication processes; generally considered to have more demanding building standards than facilities housing heavy industry in terms of sophisticated clean rooms, vibration dampening, biohazard containment, and higher electrical capacity as well as security provisions, high-speed Internet connections, and building design and layout.

high technology. Commonly used to describe a real estate market segment that deals in or is related to technologically advanced products, e.g., computers, electronics, semiconductors. New variations include robotics, the use of computer-controlled robots to perform tasks once done by humans, and biotechnology in the life sciences, e.g., genetic engineering and the synthesis and manufacture of biological products; also called *high tech.*

highway capacity. The amount of traffic a roadway can accommodate; controlled by the types of vehicles using the highway, the number and width of travel lanes, the allowable speed, road curvature and topography, and the access limitations and development controls of adjacent real estate.

highway easement. A right granted or taken for the construction, maintenance, and operation of a highway.

highway frontage. Land that is adjacent to and abuts a highway right of way.

H

analysis expands on a market analysis by addressing a specific property. *See also* **market analysis; six-step process.**

marketable title. A title not subject to reasonable doubt or suspicion of invalidity in the mind of a reasonable, intelligent person; one which a prudent person guided by competent legal advice would be willing to accept and purchase at market value.

market analysis. The study of the supply and demand in a specific area for a specific type of property. *See also* **six-step process.**

market approach

1. A term formerly used to refer to the sales comparison approach. *See* **sales comparison approach.**
2. A valuation technique that "provides an indication of value by comparing the subject asset with identical or similar assets for which price information is available. It describes the fundamental assumptions on which the reported value will be based, e.g., the nature of the hypothetical transaction, the relationship and motivation of the parties and the extent to which the asset is exposed to the market. The appropriate basis will vary depending on the purpose of the valuation." (IVS)

market area. The geographic region from which a majority of demand comes and in which the majority of competition is located. Depending on the market, a market area may be further subdivided into components such as primary, secondary, and tertiary market areas, or the competitive market area may be distinguished from the general market area. *See also* **competitive market area.**

market area analysis. *See* **neighborhood analysis.**

market area delineation. The process of identifying the geographic area where a majority of competition is located and from which a majority of demand is drawn.

market conditions. An element of comparison in the sales comparison approach; comparable properties can be adjusted for differences in the points in the real estate cycle at which the transactions occur. Sometimes called a *time adjustment* because the differences in dates of sale are often compared, although that usage can be misleading because property values do not change merely as the result of the passage of time.

market cycle. The overall interval of time during which supply and demand fluctuates from oversupply to undersupply.

market data approach. *See* **market approach; sales comparison approach.**

market data grid. A tabular representation of market data organized into useful, measurable categories.

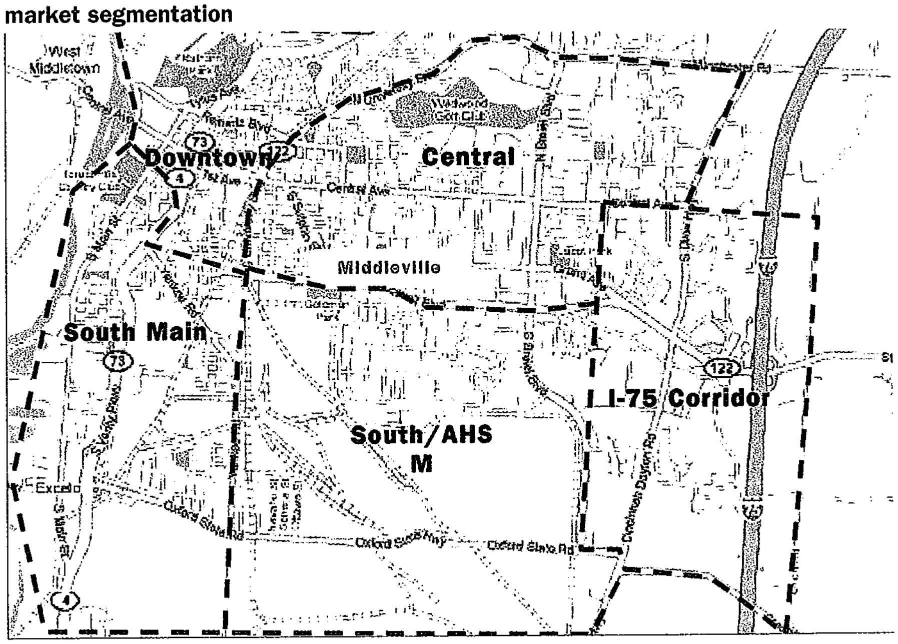
market disequilibrium. A general characteristic of real estate markets over the short term in which the supply and demand for real estate are out of balance.

market economy. An economy that operates through free competition among producers and retailers, with consumer behavior reflecting individual preferences and purchasing power; as opposed to a *command economy.*

market equilibrium. The theoretical balance where demand and supply for a property, good, or service are equal, with the only vacant space being space needed to service the market friction of normal tenant movements and space needed to accommodate new demand coming into the market. Over the long run, most markets move toward equilibrium, but a balance is seldom achieved for any period of time.

M

market segmentation



balance of supply and demand. *See also* **equilibrium vacancy; stabilized occupancy.**

market value. A type of value that is the major focus of most real property appraisal assignments. Both economic and legal definitions of market value have been developed and refined, such as the following.*

1. The most widely accepted components of market value are incorporated in the following definition: The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.
2. Market value is described, not defined, in the Uniform Standards of Professional Appraisal Practice (USPAP) as follows: A type of value, stated as an opinion, that presumes the transfer of a property (i.e., a right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal.
   Comment: Forming an opinion of market value is the purpose of many real property appraisal assignments, particularly when the client's intended use includes more than one intended user. The conditions included in market value definitions establish market perspectives for development of the opinion. These conditions may vary from definition to definition but generally fall into three categories:

* For further discussion of this term, see *The Appraisal of Real Estate*, 14th ed. (Chicago: Appraisal Institute, 2013), 58–60.

1. the relationship, knowledge, and motivation of the parties (i.e., seller and buyer);
2. the terms of sale (e.g., cash, cash equivalent, or other terms); and
3. the conditions of sale (e.g., exposure in a competitive market for a reasonable time prior to sale).

Appraisers are cautioned to identify the exact definition of market value, and its authority, applicable in each appraisal completed for the purpose of market value.
(USPAP, 2016-2017 ed.)

USPAP also requires that certain items be included in every appraisal report. Among these items, the following are directly related to the definition of market value:

- Identification of the specific property rights to be appraised.
- Statement of the effective date of the value opinion.
- Specification as to whether cash, terms equivalent to cash, or other precisely described financing terms are assumed as the basis of the appraisal.
- If the appraisal is conditioned upon financing or other terms, specification as to whether the financing or terms are at, below, or above market interest rates and/or contain unusual conditions or incentives. The terms of above- or below-market interest rates and/or other special incentives must be clearly set forth; their contribution to, or negative influence on, value must be described and estimated; and the market data supporting the opinion of value must be described and explained.

3. The following definition of market value is used by agencies that regulate federally insured financial institutions in the United States: The most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
   - Buyer and seller are typically motivated;
   - Both parties are well informed or well advised, and acting in what they consider their best interests;
   - A reasonable time is allowed for exposure in the open market;
   - Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
   - The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

   (12 C.F.R. Part 34.42(g); 55 *Federal Register* 34696, August 24, 1990, as amended at 57 *Federal Register* 12202, April 9, 1992; 59 *Federal Register* 29499, June 7, 1994)
4. The International Valuation Standards Council defines *market value* for the purpose of international standards as follows: The estimated amount for which an asset or liability should exchange on the *valuation date* between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion. (IVS)
5. The Uniform Standards for Federal Land Acquisitions defines *market value* as follows: Market value is the amount in cash, or on terms reason-

ably equivalent to cash, for which in all probability the property would have sold on the effective date of the appraisal, after a reasonable exposure time on the open competitive market, from a willing and reasonably knowledgeable seller to a willing and reasonably knowledgeable buyer, with neither acting under any compulsion to buy or sell, giving due consideration to all available economic uses of the property at the time of the appraisal. (Uniform Appraisal Standards for Federal Land Acquisitions)

market value of the going concern. The market value of an established and operating business including the real property, personal property, financial assets, and the intangible assets of the business.

market value of the total assets of the business (MVTAB). The market value of all of the tangible and intangible assets of a business as if sold in aggregate as a going concern.

mark-to-market. The act of recording the value of a security, portfolio, or account to reflect its current fair value rather than its book value. *See also* **fair value.**

marshland. Areas that are frequently inundated or saturated by surface water or groundwater and that support vegetation typically adapted for life in saturated soil conditions; generally includes swamps, marshes, bogs, and similar areas.

Massachusetts trust. A form of business organization, distinct from a corporation or partnership, that conducts its business through a trustee or trustees who hold legal title to the property of the business. Capital contributions are made to the trustees by beneficiaries, whose equitable title and interests in the property of the trust are evidenced by trust certificates. The beneficiaries receive the earnings of the trust and may enjoy limited liability, but control and management of the trust rest solely with the trustees.

mass appraisal. The process of valuing a universe of properties as of a given date using standard methodology, employing common data, and allowing for statistical testing. (USPAP, 2016-2017 ed.) Often associated with real property tax assessment valuation.

mass appraisal model. A mathematical model used to develop values for each property within a group or universe of properties.

master lease

1. A lease in which the fee owner leases a part or the entire property to a single entity (the master lessee) in return for a stipulated rent. The master lessee then leases the property to multiple tenants.
2. The first lease in a sandwich lease. *See also* **sublease.**

master plan. A comprehensive, long-range official plan that guides the physical growth and development of a community, combined with the basic regulatory and administrative controls needed to attain the physical objectives; includes land use plan, thoroughfare plan, community facilities plan, and public improvements program. Master plans are usually revised periodically (e.g., every five years). In some jurisdictions, the master plan takes precedence over the existing zoning; also called *city plan*, *general plan*, or *comprehensive plan.*

material witness. A witness who can testify about matters having some logical connection with the consequential facts, especially if few others, if any, know about those matters; a person who is capable of testifying in some relevant way in a legal proceeding. (Black's)

M

S

safe rate. The minimum required rate of return on invested capital. Theoretically, the difference between the total rate of return and the safe rate is considered a premium to compensate the investor for risk, the burden of management, and the illiquidity of the capital invested; also called *riskless rate* or *relatively riskless rate.*

sale contract. A written document signed by a buyer and a seller who agree to the transfer of ownership of real property; also called *agreement of sale* or *earnest money contract. See also* **contract date.**

sale-leaseback. A transaction in which real estate is sold by its owner-user, who simultaneously leases the property from the buyer for continued use. Under this arrangement, the seller receives cash from the transaction and the buyer is assured a tenant.

sale price. *See* **price.**

sales breakpoint. *See* **breakpoint.**

sales commission. A fee paid to the salesperson or broker who arranges for the sale of property; generally expressed as a percentage of the sale price.

sales comparison approach. The process of deriving a value indication for the subject property by comparing sales of similar properties to the property being appraised, identifying appropriate units of comparison, and making adjustments to the sale prices (or unit prices, as appropriate) of the comparable properties based on relevant, market-derived elements of comparison. The sales comparison approach may be used to value improved properties, vacant land, or land being considered as though vacant when an adequate supply of comparable sales is available.

sales ratio study. A ratio study that uses sales prices as proxies for market values. (IAAO)

sales rider. An addendum to a sale contract written on a separate piece of paper and attached to the document.

salvage value. The price expected for a whole property (e.g., a house) or a part of a property (e.g., a plumbing fixture) that is removed from the premises usually for use elsewhere.

salvage yard. A collection site for discarded or ruined material that may have some recoverable value for component parts or recyclable material.

SAM. *See* **shared appreciation mortgage.**

sandwich interest. *See* **subleasehold estate.**

sandwich lease. A lease in which an intermediate, or sandwich, leaseholder is the lessee of one party and the lessor of another. The owner of the sandwich lease is neither the fee owner nor the user of the property; he or she may be a leaseholder in a chain of leases, excluding the ultimate sublessee.

sandwich leaseholder. The lessor under a sandwich lease.

sandwich leasehold estate. The interest held by the sandwich leaseholder when the property is subleased to another party; a type of leasehold estate.

satellite cities. Subordinate or bedroom communities in a metropolitan area that have vital economic ties with the central city.

satellite tenant. An independent merchant or an affiliate of a national between an urban location and real property value.

urban structure. The orderly arrangement of discrete economic functions within the overall urban system, which reflects the community's cumulative land use needs over a number of years; the aggregation of land uses that act as a support system for the land use on any given site.

usable area

1. For office buildings, the actual occupiable area of a floor or an office space; computed by measuring from the finished surface of the office side of corridor and other permanent walls, to the center of partitions that separate the office from adjoining usable areas, and to the inside finished surface of the dominant portion of the permanent outer building walls. Sometimes called *net building area* or *net floor area*. *See also* **floor area.**
2. The area that is actually used by the tenants measured from the inside of the exterior walls to the inside of walls separating the space from hallways and common areas.

usable site area. The area of a site that can legally and physically accommodate buildings or significant site improvements. The usable site area equals the total site area less certain obstructions, such as flood hazard areas, required natural buffers, cemeteries, archeologically restricted areas, ecologically restricted areas, areas within certain restrictive easements, and other obstructions. The net site area or usable site area should be more precisely defined in each appraisal because the significance of improvements or the obstruction depends on the specific assignment.

use. An element of comparison in the sales comparison approach; comparable properties can be adjusted for differences in highest and best uses or zoning. *See also* **zoning.**

use classification. Categories into which real estate can be divided according to its use. *See also* **Property Types and Subtypes** in the Addenda.

use density. The number of buildings of a particular use classification per unit of area; sometimes expressed as a percentage of land coverage or density of coverage; also called *density of use.*

useful life. The period of time over which a structure or a component of a property may reasonably be expected to perform the function for which it was designed.

use value. The value of a property assuming a specific use, which may or may not be the property's highest and best use on the effective date of the appraisal. Use value may or may not be equal to market value but is different conceptually. *See also* **value in use.**

use value assessment. An assessment based on the value of property as it is currently used, not on its market value considering its highest and best use. This sort of assessed value is sometimes used where legislation has been enacted to preserve farmland, timberland, or other open space land on urban fringes.

use variance. A decision by a board of adjustment that grants a property owner the right to develop or use his or her property in a manner that violates the strict terms of the applicable zoning authority; granted on a property-by-property basis. *See also* **special use permit; zoning variance.**

USPAP. *See* **Uniform Standards of Professional Appraisal Practice.**

UST. *See* **underground storage tank.**

usufruct. The right of limited duration to use and derive benefit (fruits) from property belonging to another without

U

value added

1. In the cost approach, the amount that the market value of the real property increases if a specific item is fixed.
2. In general, a measure of the increase in value of assets above and beyond the cost of the assets through the process of production, e.g., the effect on the market value of an existing shopping center of a re-leasing and marketing program that repositions the property in the market.

value after the taking. In condemnation, the market value of the remainder parcel in a partial taking.

value before the taking. In condemnation, the market value of the whole property prior to the taking.

value indication. A valuer's conclusion of value resulting from the application of an approach to value, e.g., the value indication by the sales comparison approach.

value in exchange. A type of value that reflects the amount that can be obtained for an asset if exchanged between parties. Examples include market value, fair value, liquidation value, and disposition value.

value in use. The value of a property assuming a specific use, which may or may not be the property's highest and best use on the effective date of the appraisal. Value in use may or may not be equal to market value but is different conceptually. *See also* **use value.**

value of the total assets of a business (VTAB). The value of a going concern (i.e., the business enterprise).

value opinion. *See* **assignment results.**

valuer. One who is expected to provide services relating to the value of property in an unbiased and competent manner. (SVP)

vanilla box. Partially finished interior improvements consisting of taped and finished demising partitions ready for painting or wall covering, suspended ceiling grid (or its equivalent) with lighting, and finished floor surface ready for installation of carpeting, vinyl composition tile, or wood. Sometimes referred to as *vanilla box finish.*

variable-amortization loan. A mortgage loan in which amortization payments may not be required for an initial period (i.e., in a standing loan) or may be increased or decreased during the loan term. The rate of interest on the outstanding principal remains the same, but the amount of interest paid differs because the outstanding principal varies as the loan is amortized. *See also* **variable-payment mortgage (VPM).**

variable annuity. An income stream in which the payment amounts vary per period.

variable expenses. Operating expenses that generally vary with the level of occupancy or the extent of services provided.

variable-payment mortgage (VPM). A mortgage that calls for installment payments of varying amounts during its term; may or may not be fully amortized, or liquidated, at maturity. *See also* **constant-payment mortgage; variable-amortization loan.**

variable-rate mortgage (VRM). A mortgage that (1) adjusts the rate, either based on an index or by basis points specified in the mortgage contract, sometimes with caps on the change per year or over the term of the mortgage; or (2) adjusts the term to keep the payment constant or minimize its change. Also called an *adjustable-rate mortgage (ARM).*

variance. In zoning, permission from the responsible agency for a specified violation of a code or ordinance. *See also* **zoning variance.**

V

EXHIBIT B

frictional vacancy. The amount of vacant space needed in a market for its orderly operation. Frictional vacancy allows for move-ins and move-outs. *See also* **downtime; tenant turnover; vacancy.**

FRM. *See* **fixed-rate mortgage.**

frontage. The measured length of a site that abuts a street, body of water, railroad, or other geographical feature of the land.

frontage road. A local street that parallels a limited-access highway, services abutting properties, and gathers and controls vehicles entering or leaving the major traffic artery.

front foot. A land measure one foot in length taken along the frontage of a property.

front-foot cost. The cost of a property expressed in terms of the amount of linear frontage along a desirable border (e.g., a street or lake).

front land-rear land concept. *See* **backland theory.**

front money

1. The cash outlay required to launch a project.
2. Money that must be spent before financing is available.

FRT. *See* **federally related transaction.**

FTZ. *See* **foreign trade zone.**

fuel service. The improvements used in the dispensing and sale of retail motor fuel. Fuel service includes underground storage tanks (USTs), dispensers, canopies, electronics, and piping.

full-covenant-and-warranty deed. *See* **warranty deed.**

full-service car wash. A car wash facility that requires no customer involvement.

full-service gross lease. *See* **gross lease.**

full-service hotel. A hotel that provides a more complete set of services than extended-stay or limited-service hotels.

full-service lease. *See* **gross lease.**

full-service restaurant. A restaurant facility that prepares and serves food with sit-down dining for the patrons, along with preparation and serving of alcoholic beverages.

fully amortizing mortgage loan. A loan with equal, periodic payments that provide for both payment of interest and reduction of principal such that the loan is fully repaid over the loan term.

fully net lease. *See* **absolute net lease; net lease.**

functional inutility. Impairment of the functional capacity of a property or building according to market tastes and standards; equivalent to functional obsolescence when ongoing change makes layouts and features obsolete and impairs value.

functional obsolescence. The impairment of functional capacity of improvements according to market tastes and standards. *See also* **curable functional obsolescence; incurable functional obsolescence.**

functional utility. The ability of a property or building to be useful and to perform the function for which it is intended according to current market tastes and standards; the efficiency of a building's use in terms of architectural style, design and layout, traffic patterns, and the size and type of rooms.

fundamental analysis. A prediction of future market conditions based on comparison of a quantified estimate of future demand with a quantified estimate of future supply; also known as *fundamental demand analysis. See also* **inferred analysis.**

fundamental demand. The quantity of a particular type of real estate product that is desired by and affordable to the space users in a given market at

EXHIBIT C

ratio and, as a result, the increases or decreases are compounded.

exposure time

1 The time a property remains on the market.

2. [The] estimated length of time that the property interest being appraised would have been offered on the market prior to the hypothetical consummation of a sale at market value on the effective date of the appraisal. Comment: Exposure time is a retrospective opinion based on an analysis of past events assuming a competitive and open market. (USPAP, 2016-2017 ed.) *See also* **marketing time.**

expressway. A highway with full or partial control of access where major crossroads are separated in grade from the roads for through traffic of all types.

expropriation. A synonym for *eminent domain* used outside the United States.

extended-stay hotel. A hotel designed and operated for travelers who must stay in an area for a prolonged period, typically five or more consecutive days; differs from other types of hotels in that the rooms and amenities have a more residential atmosphere (e.g. kitchenettes, separate eating areas, separate office space areas).

extension agreement. An instrument that grants further time to pay an obligation or to fulfill the requirements of a contract.

exterior-corridor property. Typically, an older, one- or two-story property where room doors open directly into the parking lot or a second-story landing or walkway; most often used to describe an apartment or lodging property.

exterior description. The part of a building description that provides information about the details of the building's substructure, superstructure, and exterior components.

exterior-rollover car wash. A type of automated car wash in which the vehicle is driven into the center of the building and robotic equipment washes the vehicle. Exterior-rollover car washes can be located on sites too small to accommodate exterior-only systems.

external conformity. The compatibility between a property and its surroundings.

externalities

1. The principle that economies outside a property have a positive effect on its value while diseconomies outside a property have a negative effect on its value.
2. In appraisal, off-site conditions that affect a property's value. Exposure to street noise or proximity to a blighted property may exemplify negative externalities, whereas proximity to attractive and well-maintained properties or easy access to mass transit may exemplify positive externalities.

external obsolescence. A type of depreciation; a diminution in value caused by negative external influences and generally incurable on the part of the owner, landlord, or tenant. The external influence may be either temporary or permanent.

extraction

1. A method of estimating land value in which the depreciated cost of the improvements on an improved property is calculated and deducted from the total sale price to arrive at an estimated sale price for the land.
2. A method of deriving capitalization rates from property sales when sale price and net operating income are known.

extraordinary assumption. An assumption, directly related to a specific assignment, as of the effective date of the

E

EXHIBIT D

FEATURES

You Can't Get the Value Right If You Get the Rights Wrong

by David C. Lennhoff, MAI, SRA

Market value opinions of the fee interest in custom-built commercial properties present challenging problems. In these assignments, appraisers must understand the nuances between value in use and market value, and fee simple estates and leased fees. These built-to-suit properties have rents, sale prices, and overall capitalization rates that are not representative of the market for second-generation users. The cost to build and worth to the initial owner or tenant well exceeds what the property would be able to command on the market for either lease or sale. This article reviews the three traditional valuation approaches and discusses the misconceptions that lead to the wrong value for the property fee interest.

Single-tenant, built-to-suit commercial real estate presents difficult valuation problems. One of the most challenging of these valuation problems arises when the assignment involves developing an opinion of the market value of the fee interest in the real property. This assignment condition requires the appraiser to value the property as if it sold, *available to be leased at market*. However, these custom-built properties are always occupied by the owner or tenant for whom the improvements were built, with any lease structured to recoup the original cost of the custom construction. If the properties were sold, they would sell as leased fees with rents well above the market rent. So, an estimate of the market value of what would actually sell would be the market value of the leased fee, which is inconsistent with the value premise. Because the value premise is inconsistent with what would sell if the property were offered for sale, appraisers frequently end up answering the wrong question: rather than the market value of the fee, they provide an opinion of the value in use of the leased fee estate based on the original lease. To properly approach such assignments, appraisers must suspend reality–as these properties never sell as if vacant and available to be leased at market–and value the properties under the assumption they are vacant and available.

These are fundamental issues in appraisal of custom-built commercial properties, and it is important to explore the root causes for the problems that appraisers may have with them. This article reviews how to approach such an assignment, considering all three traditional appraisal methods, and exposes related misconceptions that should be avoided.

Custom-Built Commercial Properties

Properties such as bank branches, fast food restaurants, freestanding pharmacies, and fitness clubs are frequently built by the owners to their specifications or built-to-suit for them. In either situation, the building is designed to conform to a particular business-model prototype. For example, Life Time Fitness health clubs are typically located in 110,000-square-foot buildings on about twelve acres, with a distinctive Federal-style architectural design. The buildings usually have two stories, three swimming pools, an expensive interior finish, and every imaginable type of fitness equipment. Walgreens' pharmacies are typically in single-story, freestanding 15,000-square-foot buildings on about two acres. These buildings also have a distinctive architectural design that features a glass entrance atrium.

For many reasons, it is often advantageous to lease the property rather than own it. This is accomplished with a build-to-suit sale/leaseback. Under these arrangements, the rental amount is based on the cost of construction. These properties are never built speculatively and then put on the market for rent or sale. Once the property is rented, the real property is often sold from investor to investor. The attractiveness of the purchase to investors, however, is more a function of the lease–rent amount, terms, and tenant–than the real estate. This is obvious from the fact that some buyers do not even bother to inspect the property before purchase.

The Appraisal Problem

Although appraisals of commercial properties are sometimes obtained for purchase price purposes, more often they are for other uses such as condemnation and tax assessment. The question the appraiser is asked to answer when the use is related to a purchase is quite different from the question to be answered when the appraisal is for one of the other possible intended uses. The purchase-related appraisal involves an opinion of how much an informed purchaser would pay for the property *as encumbered* by the lease. The appraisal for condemnation or tax purposes, however, usually calls for an opinion of the market value of the *fee* interest. The specific question then is, if this property, which was custom built for this particular occupant's needs, were on the market for the typical exposure time and available to be leased or occupied, how much would an informed purchaser be willing to pay for it?

Market Value vs. Value in Use

The primary difference between *market value* and *value in use* is that market value is couched in terms of the property's highest and best use, and is a value in exchange concept. Market value considers how much a knowledgeable buyer would pay for the defined interest as of a specified date if the property had been exposed on the market for a typical period of time. It requires the assumption of a transaction and a willing seller, regardless of whether the occupant has any intention of selling.

Value in use, on the other hand, is a function of the current use, regardless of the property's highest and best use; in its purest form it is not a value in exchange concept.[1] A property that has been custom built for the current occupant–be that an owner-occupant or tenant–will usually have a value in use that is higher than the property's market value. This is not surprising, as the improvements have been tailored to the wants and needs of the occupant, and those requirements are unlikely to be exactly the same as those of the market in general. A McDonald's restaurant, for example, is a perfect design for the McDonald's business plan, but largely undesirable for the market in general, even for another fast-food outlet.

Fee Simple vs. Leased Fee

The fee simple is perhaps one of the most misunderstood of fundamental appraisal principles. Simply put, the owner of the fee interest owns the entire bundle of rights that comes with property ownership, subject only to the four governmental powers of escheat, eminent domain, police power, and taxation. The bundle of rights includes the right to sell an interest, the right to lease an interest, the right to occupy the property, the right to mortgage an interest, and the right to give an interest away. Once the property has been leased–regardless of the terms of that lease–the owner no longer has the right of occupancy, the right to lease, or the right to give an interest away. Even if the lease is at market rent, the fee does not necessarily equal the leased fee.

The Three Approaches to Value and Market Value of the Fee Interest

All three of the traditional valuation approaches are potentially applicable in the market value estimate of the fee interest in custom-built commercial properties. Whether or not an approach can be used is a function of the availability of data and support for the elements of its application.

1. Some jurisdictions have assessment criteria that mandate a *market value in use* estimate, which usually means the exchange value of the property assuming the current use is the highest and best use.

Sales Comparison Approach

As noted, custom-built commercial properties frequently sell. Invariably, they are sold subject to the lease to the original occupant that outlined the construction specifications and is paying a rent structured on the cost to build the improvements. Therefore, the sales are most appropriately categorized as sales of the leased fee interest.

The rent for a custom-built commercial property is routinely higher than the rent for space that is not specifically designed for a tenant. Anyone who has purchased a custom home can appreciate this fact. A custom builder will build whatever you want and charge cost plus profit for it. When you sell the property, however, the market will only pay for the features it wants, not for the special features you wanted built in. This is the foundation of the concept of functional obsolescence and superadequacy.

The transactions or sales of the leased fee interests for the custom properties are at prices that reflect the very high lease rate; typically the leases are net lease deals. The purchases are tantamount to a bond purchase, as the quantity, quality, and durability of the income streams being purchased are consistent with bonds. These are not arm's-length leases. The transactions are not representative of the amount for which the real property would sell if it were vacant and available to be leased (a fee interest) or leased in an arm's-length, open market transaction.

Sometimes, the only available comparable sales are net lease deals. In such circumstances, the appraiser has two choices: (1) find the evidence to support an adjustment for both rights appraised (the fee and the leased fee) and for an adjustment for the contribution of the above-market lease amount and terms; or (2) not apply the sales comparison approach. The only alternative would be to find sales of second-generation uses of these properties; for example, a reuse of a Walgreens as a local restaurant or a Kmart as a call center. If these sales are not distress sales and share the same highest and best use as the subject if vacant and available to be leased, then they will provide credible evidence of the subject's market value. More times than not, however, ample transactions of this kind are not available and the appraiser is not able to use the sales comparison technique.

Income Capitalization Approach

Direct capitalization seems to be the preferred model to develop an opinion of value for custom commercial properties via the income capitalization approach. To apply this approach properly, support is needed for its three major ingredients: potential gross income, operating expenses, and overall capitalization rate. The same issues arise with its application as with the sales comparison approach when the appraisal problem involves estimating the market value of the fee simple interest of the custom-built property.

The first step in applying the income capitalization approach is to determine the market rent. In order to properly develop the market rent, sufficient market evidence must be found of the amount that a willing lessee would pay a willing lessor to occupy the space. A search of sources usually available to appraisers (such as CoStar, NNNEx.com, or similar services) will quickly reveal many leases. When these leases are scrutinized, however, it will be apparent that almost every one is a lease to the original tenant based on a rate that was driven by that tenant's custom-construction specifications. As such these lease rents have little in common with the rent a second-generation tenant would be willing to pay for the space. Evidence of this is both obvious and available.

For example, when the fast-food franchise Roy Rogers Restaurants closed, many of its stores went to other fast-food franchises or to local restaurants. However, the buyers stripped the restaurants to their shells, removing all evidence of the prior user, and then rebuilt the restaurants to their own prototypical specifications. The buyers clearly did not want–nor were they willing to pay for–the sometimes expensive custom features of the original construction. So, it quickly becomes apparent that what may look like a substantial pool of potential leases that might be used as comparables in an estimate of market rent for the subject is really of no use whatsoever in determining how much a second-generation tenant would be willing to pay in rent for these custom-built properties.

Alternatively, an appraiser might develop a market rental rate using percentage rent, a typical retail lease mechanism. Percentage rent is expressed as a certain percentage of the typical sales for the type of tenant best suited to the particular real estate. An indication of market rent can be developed if the appropriate percentage can be found, from a review of actual leases or from a secondary source such as *Dollars and Cents of Shopping Centers*, and the typical sales can be similarly established.

Support for the operating expenses is usually not a problem, so the next step is development of an overall capitalization rate. *The Appraisal of Real Estate*, 13th edition, describes the methods for developing a capitalization rate, and it states that the preferred method is derivation from comparable sales.[2] However, the problem with derivation from comparables sales related to custom commercial buildings is the same as the problem encountered when trying to use the sales comparison approach: transaction prices for this type of property are based on the in-place lease to the original tenant and the rent being paid by that tenant, which is a function of the build-to-suit cost of construction. As a result, any capitalization rate extracted from these sales will be much lower than appropriate for an opinion of the market value of the fee interest.

Although substantial obstacles need to be overcome, application of the income capitalization approach is important to the solution of this type of appraisal problem. Careful analysis of second-generation lease transactions and overall capitalization rates extracted from these sales offers the best application. In the absence of sufficient data from second-generation deals, an option would be to estimate market rent using a percentage rent model and to develop an overall capitalization rate by an alternative method, such as a carefully vetted survey. Particular care would be needed, however, with the development of both the market rent and the overall capitalization rate.

The Cost Approach

Initially, the cost approach seems to carry a lot of promise as a method for valuing custom-built commercial properties. The value of the fee simple interest is estimated by adding the value of the land to the cost of the improvements, minus depreciation. The three components of the cost approach–cost new, depreciation, and site value–are all capable of being supported by solid market evidence. There may be problems, however, with the way the depreciation component is developed.

The amount of depreciation is estimated using one or more of three fundamental methods: the economic age-life method, the market extraction method, and the breakdown method. The market extraction method has little application to custom-built commercial properties for the same reasons the sales comparison approach is not useable, i.e., the lack of similar sales. The breakdown method also is not particularly practical. The method used most often is the economic age-life method. The problem with the economic age-life method is that appraisers frequently select an effective age equal to or close to actual age, based solely on physical condition, and take the total economic life from a published source. For custom-built properties, this inevitably results in an understatement of the depreciation, as these properties almost by definition have features that the general market is not willing to pay for.

Feasibility Rent Analysis

The key to the cost approach is the accurate measurement of functional and external obsolescence elements of depreciation. Often, even very new properties suffer substantial functional and external obsolescence.

Feasibility rent analysis is one of the very best tools available to show the magnitude of depreciation. It helps explain why cost new, even with a relatively new property, does not approximate market value. If the feasibility rent is above the market rent, then the property has obsolescence and cost new will exceed the market value.

The feasibility rent concept is taught in the Appraisal Institute's highest and best use courses, although there it is used to estimate the timing of a use rather than to quantify existing depreciation. Although some appraisers may be put off by the circularity that exists between feasibility rent analysis and direct capitalization, it is a methodology taught in the *Advanced Cost and Sales Comparison* course, which is currently a requirement for the MAI designation.

Feasibility rent analysis is, in effect, direct capitalization in reverse. Direct capitalization begins with an estimate of market rent from which appropriate vacancy and collection loss and operating expenses are deducted. The resulting net operating income is then converted to an indication of value by dividing it by an overall capitalization rate (R_o).

Feasibility rent, on the other hand, begins with the assumption that the cost new plus the site value equals value. Rearranging the relationship, value equals income divided by rate, allows the appraiser to calculate feasibility rent, or the net operating income necessary to support this assertion (net operating income equals cost new plus site value times the overall capitalization rate). The difference

2. Appraisal Institute, *The Appraisal of Real Estate*, 13th ed. (Chicago: Appraisal Institute, 2008), 501.

between this amount and the estimated net operating income developed in the income capitalization approach represents the net income shortfall, which when capitalized with the overall capitalization rate results in the total depreciation from all sources. Dividing the net income shortfall by the previously calculated feasibility rent results in the total percentage of depreciation in the improvements.

An example using a custom-built property helps illustrate why feasibility rent is a valuable tool in explaining why the cost new does not approximate market value for this type of property.

Feasibility Rent Case Study

Assume that the subject is a two-year-old health club with 110,000 square feet of improvements on twelve acres. The site value, determined by the sales comparison approach, is $3,500,000, and the all-inclusive cost new for the real property (personalty excluded) is $177.00 per square foot. This includes entrepreneurial incentive, which is a necessary cost in all market value estimates. (Unachieved profit would be reflected in the depreciation estimate.) The physical depreciation for the facility is $500,000. Although only two years old, this facility has been operated on a 24-hour-a-day basis and shows minor physical depreciation as a result.

Also assume that the estimated market rent by percent typical for similar retail is 8%; the typical sales level is $120 per square foot; and the market rent is $9.60 per square foot. The overall capitalization rate is 9%, based on analysis of the subject relative to alternative retail investment opportunities such as strip centers, power centers, and hotels.

We can now calculate the feasibility rent, which is the rent necessary for the property to be worth what it cost to construct at the effective date of value.

Cost new of improvements	$19,470,000
Site value	+ 3,500,000
Total cost new	$22,970,000
Capitalization rate	× 9%
Feasibility rent	$2,067,300

We can now compare the market rent estimate to the feasibility rent (both on a net basis). The difference between the two serves as a market-extracted measure of total depreciation in the subject real property. The depreciation calculation using feasibility rent analysis is as follows:

Total development cost new	$22,970,000
Capitalization rate	× 9%
Feasibility rent	$2,067,300
Less net market rent ($9.60 × 110,000 sq. ft.)	– 1,056,000
Income loss due to depreciation, all sources	$1,011,300
Value of loss, capitalized at 9% ($1,011,300/.09)	$11,236,666

Of the total loss in value, $500,000 is physical depreciation, so the property suffers the balance $10,736,666 in functional or external obsolescence. It is not particularly important in this situation to identify how much of this amount is functional obsolescence and how much is external obsolescence. A reconstructed cost approach would look as follows:

Cost new		$19,470,000
Less depreciation		
Physical deterioration	$500,000	
Functional/external obsolescence	$10,736,666	
Total depreciation		– 11,236,666
Depreciated value of improvements		$8,233,334
Site value		+ 3,500,000
Total market value of fee by cost approach		$11,733,334

It is important to emphasize that the cost approach did *not* produce an independent indication of value. However, it did provide a very useful way of demonstrating that, although only two years old, this property suffers substantial functional or external obsolescence and its market value is significantly less that its value in use would be.

Summary and Conclusions

Estimating the market value of the fee interest in the real property component of a single-tenant, built-to-suit or custom-built commercial property is a difficult assignment. The reason it is so difficult is that no one builds these properties on a speculative basis and then offers them for sale or rent on the open market. Instead, they are built-to-suit, and if they sell, they trade on a sale/leaseback arrangement. The rent, sale price, and overall capitalization rate are not arm's-length and not equivalent to market rent, value, or capitalization rates. As a result, it is very difficult to find support for market rent, market sales comparables, and market overall capitalization rates. However, the value in use to a specific tenant or owner does not become market value just because support for the latter is hard to find. The best support for the components of both the sales comparison approach (the comparables) and the components of the income capitalization approach (rental and capitalization rate comparables) is second-generation space that has leased or sold and that enjoys the same highest and best use as the subject would if it were available for lease or sale on the open market. The key to the cost approach is the accurate quantification of the functional and external obsolescence. Feasibility rent analysis is an excellent tool for such quantification in these situations.

Appraisers often respond to these types of appraisal assignments by asking, why would an intelligent and sophisticated national corporation pay an amount well above the market value or market rent for these custom-built properties? The answer is simply this. The cost of the real estate might not make sense on a stand-alone basis, but makes complete sense as a part of the overall business operation of the owner or tenant. When a nationally known fast-food establishment was asked why it had paid what was seemingly well above the market value for land for one of its restaurants, the response was, "We're not in the real estate business, we're in the hamburger business. The land price is completely acceptable as a part of the overall business plan, and that is all we care about." However, no one else would be willing to pay either rent or a sale price for custom-built improvements that fit perfectly into someone else's business plan, but not their own. The price a buyer is willing to pay would be well below the cost-based amounts, and this represents the very crux of this valuation issue.

David C. Lennhoff, MAI, SRA, is president of PGH Consulting, LLC, which is officed in Rockville, Maryland. His practice centers on litigation valuation and expert testimony relating to appraisal methodology, USPAP, and allocating assets of a going concern. He has taught nationally and internationally for the Appraisal Institute and is a frequent contributor to *The Appraisal Journal*. **Contact: dlennhoff@aol.com**

EXHIBIT E

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Address:	Lansing MI 48917
County:	Eaton

License Information

License Type:	Certified General Real Estate Appraiser
License Number:	1201001038
Specialties:	
Status:	Active
Limitations:	
Issue Date:	11/14/2007
Expiration Date:	07/31/2018
	Continuing Education

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VERIFY A LICENSE/REGISTRATION

Licensee Information

Name:	**ABOOD, MARCUS L**
Address:	**Lansing, MI 48901**
County:	**Ingham**

License Information

License Type:	**Certified Residential RE Appraiser**
License Number:	**1201001038**
Specialties:	
Status:	**Null & Void**
Limitations:	
Issue Date:	**07/15/2003**
Expiration Date:	**07/31/2008**
	Continuing Education

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County:	Ingham

License Information

License Type:	State Licensed Real Estate Appraiser
License Number:	1201001038
Specialties:	
Status:	Null & Void
Limitations:	
Issue Date:	11/27/1991
Expiration Date:	07/31/2004
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